

ORIGINAL

OPEN MEETING ITEM



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COMMISSIONERS  
JEFF HATCH-MILLER - Chairman  
WILLIAM A. MUNDELL  
MIKE GLEASON  
KRISTIN K. MAYES  
BARRY WONG



ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION  
DOCUMENT CONTROL

DATE: October 2, 2006

DOCKET NO.: WS-01303A-06-0283

TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Amy Bjelland. The recommendation has been filed in the form of an Order on:

ARIZONA-AMERICAN WATER COMPANY, INC.

(FINANCING)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by 4:00 p.m. on or before:

OCTOBER 11, 2006

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

OCTOBER 17 AND 18, 2006

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250. For information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

Arizona Corporation Commission  
DOCKETED

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BRIAN C. McNEIL  
EXECUTIVE DIRECTOR

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 **COMMISSIONERS**

3 JEFF HATCH-MILLER, Chairman  
4 WILLIAM A. MUNDELL  
5 MIKE GLEASON  
6 KRISTIN K. MAYES  
7 BARRY WONG

8 IN THE MATTER OF THE APPLICATION OF  
9 ARIZONA-AMERICAN WATER COMPANY,  
10 INC., AN ARIZONA CORPORATION, FOR  
11 AUTHORITY TO INCUR LONG-TERM DEBT  
12 THROUGH ITS AFFILIATE, AMERICAN WATER  
13 CAPITAL CORPORATION.

DOCKET NO. WS-01303A-06-0283

**ORDER**

14 Open Meeting  
15 October 17 and 18, 2006  
16 Phoenix, Arizona

17 **BY THE COMMISSION:**

18 On April 26, 2006, Arizona-American Water Company, Inc. ("Arizona-American") filed with  
19 the Arizona Corporation Commission ("Commission") an application for authority to incur long-term  
20 debt through its affiliate, American Water Capital Corporation ("American") and for authorization of  
21 payment obligations to the City of Tolleson, Arizona.

22 \* \* \* \* \*

23 Having considered the entire record herein and being fully advised in the premises, the  
24 Commission finds, concludes, and orders that:

25 **FINDINGS OF FACT**

26 1. Arizona-American Water Company, Inc. ("Arizona-American" or "Applicant") is a  
27 Class "A" Arizona public service corporation providing water and wastewater services in portions of  
28 Mohave, Maricopa and Santa Cruz counties. Arizona-American provides utility service to  
approximately 97,000 water customers and 47,000 sewer customers in Arizona.

29 2. Arizona-American currently has three rate cases in progress for the following districts:  
30 (1) Mohave Water and Wastewater, Docket No. WS-01303A-06-0014; (2) Anthem Water and  
31 Anthem/Agua Fria Wastewater, Docket No. WS-01303A-06-0403; and (3) Sun City Wastewater and  
32 Sun City West Wastewater, Docket No. WS-01303A-06-0491.

1           3.     On April 26, 2006, Arizona-American filed an application with the Commission  
2 requesting permission to incur long-term debt through its affiliate, American Water Capital  
3 Corporation ("AWCC"). The Applicant also requested approval of an obligation to the City of  
4 Tolleson ("Tolleson"). Arizona-American published notice of its application in this matter on May  
5 15, 2006 in the *Mohave Valley Daily News*, on May 18, 2006 in the *Arizona Business Gazeette*, and  
6 on May 19, 2006 in the *Nogales International*.

7           4.     On September 15, 2006, the Commission's Utilities Division ("Staff") filed a Staff  
8 Report recommending approval of this application.

9           5.     Arizona-American asks for Commission approval to borrow \$165.45 million from  
10 AWCC for the purpose of paying off two promissory notes, totaling \$158.45 million<sup>1</sup>, which mature  
11 in November 2006, and to fund two new capital projects with \$7.0 million.

12          6.     Arizona-American anticipates obtaining a ten-year interest-only loan of \$165.45  
13 million from AWCC at an interest rate not to exceed 6.5 percent per annum. All principal is due at  
14 maturity. The actual interest rate will be determined by market conditions at the time of the  
15 transaction, and there are no expected financing costs or issuance fees. AWCC has no coverage ratio  
16 requirements for Arizona-American.

17          7.     Arizona-American has also requested Commission approval of an \$8.56 million  
18 obligation ("Obligation") to Tolleson. In its application, Arizona-American stated that it is the  
19 successor in interest to Sun City Sewer as the purchaser of sewage treatment services from Tolleson  
20 under a Sewage Treatment and Transportation Services Agreement ("Services Agreement").  
21 Tolleson issued \$8.56 million in bonds to finance the facilities needed to provide service under the  
22 Services Agreement. Payments for the bonds, guaranteed by Arizona-American, are made from  
23 revenues received under the Services Agreement. The Obligation previously was guaranteed by  
24 Citizens Utilities Company ("Citizens") in 1998, however, Arizona-American subsequently acquired  
25 the water and wastewater assets and Certificates of Convenience and Necessity held by Citizens in  
26 Arizona. The Commission authorized the acquisition in Decision No. 63584 (September 26, 2000).

27 \_\_\_\_\_  
28 <sup>1</sup> One note is for \$154,948,119 (Dec. No. 64002 (August 30, 2001)), and the other is for \$3.5 million (Dec. No. 63586 (April 14, 2001)).

1 Decision No. 63584 approved the transfer of assets and recognizes in the description of the  
2 transaction that Arizona-American would assume liabilities for contracts, but is silent regarding  
3 approval of the terms of the transaction. Arizona-American seeks to clarify this uncertainty by  
4 obtaining Commission approval in this docket for the Obligation.

5 **Engineering Analysis**

6 8. Staff Engineering reviewed the material costs estimates of the two new capital projects  
7 submitted in support of the application, expansion of its Mohave Wastewater Treatment Plant in  
8 Mohave County, and its Verrado Wastewater Treatment Plant Phase 2 expansion in Maricopa  
9 County.

10 9. Applicant plans to expand its Mohave Wastewater Treatment Plant by 250,000 gallons  
11 per day to meet projected demands and required wastewater treatment standards. The Mohave  
12 Wastewater Treatment Plant currently has a design capacity of 250,000 gallons per day. The  
13 projections of new hookups show the existing plant capacity will be exceeded by early 2008. The  
14 expansion project will include a pre-packaged 250,000 gallons per day treatment facility (matching  
15 the existing plant), solids handling facility, expanded blower building, sitework, electrical, and  
16 foundation, etc. The estimated total project cost is \$2,763,000.

17 10. Applicant plans to expand the Verrado Wastewater Treatment Plant, which has an  
18 existing capacity of 450,000 gallons per day. The projected flow will reach the existing capacity in  
19 the summer of 2007. The proposed expansion will increase treatment plant capacity from 450,000 to  
20 1,160,000 gallons per day, which will meet projected demands until 2011. The estimated total  
21 project cost is \$4,910,000.

22 11. Staff concluded that the proposed plant additions are reasonable and the estimated  
23 total project costs for the two new capital projects are reasonable. However, no "used and useful"  
24 determination of the proposed projects was made and no particular treatment should be inferred for  
25 rate making or rate base purposes in the future.

26 **Financial Analysis**

27 12. The Debt Service Coverage ("DSC") ratio represents the number of times internally  
28 generated cash will cover required principal and interest payments on long-term debt. A DSC ratio

1 greater than 1.0 means that operating cash flow is sufficient to cover debt obligations. A DSC less  
2 than 1.0 means that debt service obligations cannot be met from operations and that another source of  
3 funds is needed to avoid default.

4 13. The Times Interest Earned Ratio ("TIER") represents the number of times earnings will  
5 cover interest expense on short-term and long-term debt. A TIER greater than 1.0 means that  
6 operating income is greater than interest expense. A TIER of less than 1.0 is not sustainable in the  
7 long term but does not necessarily mean that debt obligations cannot be met in the short term.

8 14. Cash Coverage Ratio ("CCR") represents the number of times internally generated  
9 cash covers required interest payments on short-term and long-term debt. A CCR greater than 1.0  
10 means that operating cash flow is greater than interest expense.

11 15. For the year ended December 31, 2005, Staff's financial analysis shows Arizona-  
12 American had a 0.52 TIER, a 2.05 DSC and a 2.06 CCR. Staff's pro forma analysis, reflecting the  
13 effect of the AWCC debt proposed by Arizona-American assuming a 6.5 percent annual interest rate  
14 and 10-year amortization shows a decline to a 0.46 TIER, a 1.81 DSC, and a 1.82 CCR.

15 16. Arizona-American's TIER results reflect that operating income would suffice to cover  
16 interest expense in the short-term, but not in the long term. However, DSC results indicate that  
17 Arizona-American will be able to meet all obligations with cash generated from operations.  
18 Therefore, operating cash flow is sufficient to cover both principal and interest payments on short-  
19 and long-term debt obligations.

#### 20 **Capital Structure**

21 17. At December 31, 2005, Arizona-American's capital structure consisted of 8.5 percent  
22 short-term debt, 58.6 percent long-term debt, and 32.9 percent equity. Pro forma analysis reflects a  
23 capital structure composed of 8.1 percent short-term debt, 57.7 percent long-term debt and 34.2  
24 percent equity.

25 18. On March 21, 2006, Arizona-American received \$35 million in new equity from  
26 American Water Works, Inc., its parent company. The effect of this new equity on Arizona-  
27 American's equity position was partially offset by a goodwill write-off of \$24.4 million.

**Staff's Conclusions and Recommendations**

19. Based on its review and analysis, Staff concluded that authorization of the \$8.56 million Tolleson Obligation is appropriate to clarify any ambiguity regarding Commission authorization. Staff stated its conclusion that the estimated costs associated with the new capital projects appear to be reasonable, and stated that issuance of the proposed AWCC debt financing not to exceed \$7.0 million to fund new capital projects and not to exceed \$158.45 million to pay off maturing debt is within Arizona-American's corporate powers, is compatible with the public interest, is consistent with sound financial practices and will not impair its ability to provide services.

20. Staff recommended that the Commission authorize Arizona-American's request to borrow an amount not to exceed \$165.45 million in new funds from AWCC for the purposes described herein. Staff further recommended that the Commission approve Arizona-American's \$8.56 million Tolleson Obligation pertaining to the Services Agreement as successor in interest to Sun City Sewer.

21. Staff further recommended authorizing Arizona-American to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.

22. Staff recommended that the executed loan documents be filed with Docket Control within 30 days of this Decision.

23. Staff's recommendations are reasonable and should be adopted.

**CONCLUSIONS OF LAW**

1. Arizona-American is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§ 40-281, 40-282, 40-301 and 302.

2. The Commission has jurisdiction over Arizona-American and the subject matter of the application.

3. Notice of the application was given in accordance with the law.

4. Staff's recommendations are reasonable and should be adopted.

5. The financing approved herein is for lawful purposes within Arizona-American's corporate powers, is compatible with the public interest, with sound financial practices, and with the proper performance by Arizona-American of service as a public service corporation, and will not

impair Arizona-American's ability to perform that service.

6. The financing approved herein is for the purposes stated in the application and is reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably chargeable to operating expenses or to income.

## ORDER

IT IS THEREFORE ORDERED Arizona-American Water Company, Inc.'s application for authority to borrow an amount not to exceed \$165.45 million in new funds from American Water Capital Corporation for the purposes described herein shall be, and hereby is, granted.

IT IS FURTHER ORDERED that Arizona-American Water Company, Inc.'s application for authorization of its \$8.56 million obligation to the City of Tolleson Obligation pertaining to the Sewage Treatment and Transportation Services Agreement as successor in interest to Sun City Sewer shall be, and hereby is, granted.

IT IS FURTHER ORDERED that such authority is expressly contingent upon Arizona-American Water Company, Inc.'s use of the proceeds for the purposes set forth in its application.

IT IS FURTHER ORDERED that approval of the financing set forth herein does not constitute or imply approval or disapproval by the Commission of any particular expenditure of the proceeds derived thereby for purposes of establishing just and reasonable rates.

IT IS FURTHER ORDERED that Arizona-American Water Company, Inc. is hereby authorized to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.

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IT IS FURTHER ORDERED that Arizona-American Water Company, Inc. shall file with Docket Control, as a compliance item in this docket, within 30 days of this Decision, a copy of all executed documents associated with the financing authorized herein.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN

COMMISSIONER

COMMISSIONER

COMMISSIONER

COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this \_\_\_\_ day of \_\_\_\_\_, 2006.

BRIAN C. McNEIL  
EXECUTIVE DIRECTOR

DISSENT \_\_\_\_\_

DISSENT \_\_\_\_\_



1 SERVICE LIST FOR: ARIZONA-AMERICAN WATER COMPANY, INC.

2 DOCKET NO.: WS-01303A-06-0283

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